

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF CALIFORNIA

CHEVRON U.S.A., INC.,

Plaintiff,

No. C 01-3616 MHP

v.

JAMES E. LUTZ,

Defendant.

**MEMORANDUM AND ORDER**  
**re Defendant's Motion for Partial**  
**Summary Judgment**

Plaintiff Chevron U.S.A., Inc., ("Chevron") brought this action for termination of defendant James Lutz's franchise under the Petroleum Marketing Practices Act ("PMPA"), 15 U.S.C. § 2801 et seq., on grounds that defendant James Lutz ("Lutz") failed to maintain records required by the franchise lease agreement and failed to comply with state and federal tax laws in violation of the lease agreement and the PMPA. Now before the court is defendant's motion for partial summary judgment on the issue of his intent to file incorrect tax returns. Having considered the arguments presented, and for the reasons set forth below, the court rules as follows.

**BACKGROUND**

For the past 34 years, James Lutz has operated the Chevron station at 1440 East Washington Boulevard in Petaluma, California (the "service station") as a franchisee for Chevron. James Lutz Dec. ¶ 2. James Lutz's son, Dan Lutz, is employed as manager of the service station. Dan Lutz Dec. ¶ 2. Tim Lutz, James Lutz's eldest son, works as an certified public accountant for an accounting firm in San Jose,

1 California. Tim Lutz Dec. ¶ 2. For the past twenty years, Tim Lutz has prepared tax returns for the service  
2 station as well as his father's personal tax returns. Tim Lutz Dec. ¶ 4.

3 Throughout the time he has run the service station, James Lutz has operated under written lease  
4 agreements with Chevron. James Lutz Dep. at 48:11–14. On April 6, 2001, Lutz entered into a three  
5 year lease of the station from Chevron consisting of a Dealer Lease (“lease agreement”), Dealer Supply  
6 contract and related agreements (collectively “dealer agreements”). Dealer Agreements, Snyder Dec., Exh.  
7 A; James Lutz Dep. at 74:19–17:14; Joint Statement of Undisputed Facts (“JUF”) ¶ 3.

8 The previous lease agreement, signed in 1998, provided that Chevron would remodel the service  
9 station to add a convenience store and additional gasoline dispensers. JUF ¶ 12. The renovation took  
10 approximately four months and was completed on July 6, 1998. Id. ¶ 13. After the station reopened,  
11 Chevron allowed Lutz to operate at discounted rents until January 1, 1999. Rent Invoices, Toliver Dec.,  
12 Exh B. After January 1, 1999, Lutz was required to pay a rent based on a percentage of the greater of the  
13 fuel sold during that month or 125% of the fuel sold during the same calendar month the previous year.  
14 Reconstruction Agreement, Snyder Exh. C ¶ 7. Under this rent structure, the station became less profitable  
15 for the Lutz family. Dan Lutz Dep. at 63:23–64:25. In early 1999, Dan Lutz complained to Chevron about  
16 this rent structure and the resulting increase in monthly rent. Dan Lutz Dep. at 46:4–52:14.

17 The service station currently has two Electronic Point of Sale (“EPOS”) cash registers. JUF ¶ 15.  
18 The EPOS registers transmit sales information at the service station to Chevron. JUF ¶ 16. Lutz also  
19 keeps a personal computer in an office at the service station which he uses to track sales. JUF ¶ 17. Lutz  
20 maintains that there has been a history of problems with the computer system since the installation of the  
21 EPOS terminals in approximately 1992. James Lutz Dec. ¶ 5; Dan Lutz Dec. ¶ 5. In particular, the Lutzes  
22 believe that computer has at times consistently generated inaccurate data for certain sales figures. James  
23 Lutz Dec. ¶ 5; Dan Lutz Dec. ¶ 5. For example, the computers might generate accurate figures for total  
24 gas sales, but inaccurate figures for total sales. The Lutzes stated that there has been confusion in the  
25 business over which of the computer-generated figures are trustworthy. James Lutz Dec. ¶ 5; Dan Lutz  
26 Dec. ¶ 5.

1 Lutz maintains that in 1999, he experienced some difficulties with the computer in their service  
2 station, after which Dan and Tim Lutz decided that the computer was calculating the total sales figure  
3 incorrectly, although the total sales tax figure remained reliable. Dan Lutz Dec. ¶ 6; Tim Lutz Dec. ¶¶ 8–9.  
4 In preparing the taxes for the service station, rather than use the total sales figure which the computer  
5 generated, Tim Lutz calculated the total sales by dividing the total sales tax figure generated by the EPOS  
6 system by the sales tax rate. Tim Lutz Dec. ¶ 10.

7 On June 26, 2001, Everett Harry, an outside accountant retained by Chevron to conduct routine  
8 audits of several northern California service stations, visited the Service Station to review Lutz’s records.  
9 Harry Dec.¶¶ 2, 4. Harry examined records stored both at the Service Station and at Lutz’s home, made  
10 copies of some of the records, and left Dan Lutz with a list of additional documents he required to complete  
11 the audit. Id. ¶ 5. Upon reviewing the records provided, Harry discovered that the Lutz’s tax records  
12 indicated total sales of approximately half a million dollars less than the figure indicated by data reported to  
13 Chevron by the EPOS terminal over the years 1999 and 2000.<sup>1</sup> Id. ¶ 7. In discussing additional  
14 document requests with Dan and Tim Lutz in July 2001, Harry also notified both the brothers of the  
15 discrepancies his review had revealed. Id. ¶¶ 6, 9; JUF ¶ 8. Tim Lutz provided some supplemental  
16 information on July 15, 2001. Id. ¶ 10.

17 On August 9, 2001, Tim Lutz sent Harry two pages of prepared computer spreadsheets,  
18 uncorroborated by business records, with a note stating, “Hope this helps. The difference appears to be in  
19 nontaxable sales.” Id. ¶ 13. Neither the unsupported spreadsheets nor other documents subsequently  
20 received from the Lutzes completely explained to Harry the discrepancies which he had discovered. Id. ¶¶  
21 13–15. Harry reported to Chevron that in the two-year period he had audited, the total sales reflected on  
22 Chevron EPOS invoices were \$523,028 greater those shown on the service station sales tax and income  
23 tax return. Harry Report to T.S. Toliver, Harry Dec., Exh A. Based on the contents of Harry’s report,  
24 Chevron issued a Notice of Termination to Lutz on September 19, 2001. Toliver Dec. ¶ 10 & Exh A.

25 Shortly after the Chevron audit, Timothy Lutz filed amended 1999 tax returns for both the Lutz  
26 partnership and for James Lutz’s personal income. Tim Lutz Dec. ¶ 17; 1999 Amended Return, Snyder  
27 Dec., Exh. I & J. He also corrected the 2000 returns which he had prepared at the time of the audit but  
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1 not yet filed. Tim Lutz Dec. ¶ 17. No government agency has taken action against Lutz based on the  
2 handling of his 1999 income tax returns. James Lutz Dec. ¶ 18.

3  
4 LEGAL STANDARD

5 I. Summary Judgment

6 Summary judgment shall be granted when there is no genuine issue of material fact and the movant  
7 is entitled to judgment as a matter of law. See Fed. R. Civ. P. 56(c). The moving party bears the initial  
8 burden of identifying those portions of the record that demonstrate the absence of a genuine issue of  
9 material fact. The burden then shifts to the nonmoving party to “go beyond the pleadings, and by her own  
10 affidavits, or by the ‘depositions, answers to interrogatories, and admissions on file,’ designate ‘specific  
11 facts showing that there is a genuine issue for trial.’” Celotex Corp. v. Catrett, 477 U.S. 317, 324 (1986)  
12 (citations omitted). A dispute about a material fact is genuine “if the evidence is such that a reasonable jury  
13 could return a verdict for the nonmoving party.” Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248  
14 (1986). The moving party discharges its burden by showing that the nonmoving party has not disclosed the  
15 existence of any “significant probative evidence tending to support the complaint.” First Nat’l Bank v.  
16 Cities Serv. Co., 391 U.S. 253, 290 (1968). The court does not make credibility determinations in  
17 considering a motion for summary judgment. See Anderson, 477 U.S. at 249.

18 Questions involving a person’s state of mind are generally factual issues inappropriate for resolution  
19 by summary judgment. Braxton-Secret v. A.H. Robbins Co., 769 F.2d 528, 531 (9th Cir. 1985). Where  
20 the defendant’s intent is at issue, summary judgment is appropriate only if all reasonable inferences defeat  
21 the plaintiff’s claims. White v. Roper, 901 F.2d 1501, 1505 (9th Cir. 1990). Even where the basic facts  
22 are undisputed, summary judgment should not be granted where competing inferences may reasonably be  
23 drawn from those facts. Braxton-Secret, 769 F.2d at 531. Where the dispute centers on the legal effect of  
24 undisputed facts, however, the matter may properly be decided on summary judgment. Fonda v. Gray,  
25 707 F.2d 435, 438 (9th Cir. 1983).

1 II. The PMPA

2 The PMPA prohibits a franchisor of gasoline retail establishments from terminating a franchise  
3 agreement prior to the conclusion of the franchise term except in the circumstances set forth in 15 U.S.C.  
4 section 2802(b)(2). 15 U.S.C. § 2802(a). Among other grounds, section 2802(b)(2) allows termination  
5 of a franchise agreement when a franchisee breaches a provision of the franchise agreement which is “both  
6 reasonable and of material significance to the franchise relationship,” 15 U.S.C. § 2802(b)(2)(A), or upon  
7 “the occurrence of an event which is relevant to the franchise relationship and as a result of which  
8 termination of the franchise or nonrenewal of the franchise relationship is reasonable.” 15 U.S.C.  
9 § 2802(b)(2)(C).

10 Section 2802(c) sets forth a nonexhaustive list of occurrences which qualify as “events relevant to  
11 the franchise” upon which termination is “reasonable” under section 2802(b)(2)(C). Should an event listed  
12 in 2802(c) occur, the franchise may be terminated without further inquiry into whether the violation is  
13 serious enough to warrant termination. Atlantic Richfield Co. v. Guerami, 820 F.2d 280, 823 (9th  
14 Cir.1987). Included on that list and relevant to the present action are “fraud or criminal misconduct by the  
15 franchisee relevant to the operation of the marketing premises,” 15 U.S.C. § 2802(c)(1), and “knowing  
16 failure of the franchisee to comply with Federal, State, or local laws or regulations relevant to the operation  
17 of the marketing premises,” 15 U.S.C. § 2802(c)(11). The PMPA defines “failure” for purposes of the  
18 statute so as not to include “any failure which is only technical or unimportant to the franchise relationship.”  
19 15 U.S.C. § 2801(13)(A).

20 The Ninth Circuit has recognized that the chief purpose of the PMPA is to remedy the disparities in  
21 bargaining power between franchisees and franchisors in order to protect the franchisee’s reasonable  
22 expectation of continuing the franchise relationship. Unocal Corp. v. Kaabipour, 177 F.3d 755, 762 (9th  
23 Cir.1999), cert. denied, 528 U.S. 1061 (1999). Where no competing interest presents itself, the statute  
24 should be construed liberally to protect the franchisees. Id. at 765.

1 DISCUSSION

2 In his motion for summary judgment, Lutz argues that in order to terminate the franchise relationship  
3 based on Lutz's submission of incorrect tax returns, Chevron must prove that he knowingly filed false tax  
4 returns. Lutz maintains that based on the evidence presented, no reasonable jury could find that he  
5 intended to submit incorrect tax returns, thereby failing to comply with state and federal law. Before turning  
6 to the evidence of Lutz's intent to file false tax returns, the court first addresses whether Chevron need  
7 prove intent to succeed in its action for termination.

8 I. Intent Showing Required for Termination

9 Chevron maintains that defendant's filing of false income tax returns warrants termination as a  
10 violation of both the dealer agreement under section 2802(b)(2)(A) and as an event relevant to the  
11 franchise relationship under section 2802(b)(2)(C).<sup>2</sup> The provisions of the lease agreement that Chevron  
12 maintains were violated closely track the language of the relevant sections of 2802(c). Following the  
13 wording of section 2802(c)(1), the lease agreement provides for termination upon "[u]nlawful, fraudulent or  
14 deceptive acts or practices or criminal misconduct by Dealer relevant to the operation of the  
15 Premises . . . ." Lease Agreement, Snyder Dec., Exh. A ("Lease Agreement") ¶ 7(b)(8). For Lutz's  
16 understatement of income to qualify as fraudulent under these terms, he must have knowingly and  
17 intentionally misrepresented his true income. See Bradford v. Comm'r of Internal Revenue, 796 F.2d 303,  
18 307 (9th Cir. 1986) (defining fraud under 26 U.S.C. § 6653 as intentional wrongdoing with the specific  
19 intent to avoid a tax); Black's Law Dictionary 670 (7th ed. 1999) (defining fraud as a "knowing  
20 misrepresentation of the truth or concealment of a material fact").

21 The lease agreement also provides for termination if the franchisee "knowingly fails to comply with  
22 Federal state or local laws or regulations relevant to the use or operation of the [station,]" Lease  
23 Agreement ¶ 7(b)(4). This term is in all material ways equivalent to subsection 2802(c)(11). The text of  
24 these provisions clearly states that a failure to comply with the law must be knowing in order to warrant  
25 termination.

26 Chevron also points to paragraph 2(c) of the lease agreement, which states that "Dealer shall . . .  
27 (10) comply with all applicable Federal state and local laws and regulation relevant to the use or operation  
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1 of the Premises . . . .” Lease Agreement ¶ 2(c)(10). This articulation of Lutz’s obligations goes so far as to  
2 include unknowing and unintentional violations of the law.

3 Under the PMPA, however, violation of a contractual term of the lease agreement may only result  
4 in termination of the franchise where the provision violated is “reasonable and of material significance to the  
5 franchise relationship.” 15 U.S.C. § 2802(b)(2)(A). Congress addressed violations of law as a grounds  
6 for franchise termination directly in section 2811(c)(11) and determined that only knowing violations would  
7 be “relevant to the franchise relationship” and a “reasonable” ground for termination. 15 U.S.C.  
8 §§ 2802(b)(2)(C), 2802(c). Allowing Chevron to expand the statutory grounds for termination simply by  
9 writing stricter terms into its contracts would frustrate the PMPA’s purpose of protecting the franchisee  
10 from uneven bargaining power and would transform Congress’s explicit judgments on the proper grounds  
11 for termination into a list of suggestions for fair franchise agreements. This the court declines to do. Insofar  
12 as paragraph 2(c)(10) of the contract conflicts directly with statutory grounds for termination set forth in  
13 section 2911(c)(11) by allowing termination based on unknowing and unintentional violations of the law, the  
14 court finds that the provision of the lease agreement is not “reasonable and of material significance to the  
15 franchise.” An unknowing failure to comply with federal, state or local laws or regulations is not grounds  
16 for termination under the PMPA.

17 All of the provisions of the lease agreement and the PMPA under which Chevron claims termination  
18 is proper require that the franchisee engage in fraud or other knowing violation of the law. Chevron  
19 therefore must prove that Lutz knowingly understated his income on his 1999 tax returns in order to prevail  
20 in this action.

21 II. Imputation of Intent of Lutz’s Sons to Lutz

22 Lutz argues that Chevron cannot survive summary judgment on the grounds stated in the complaint  
23 by providing only evidence that Tim or Dan Lutz intended to file false tax returns, but must submit evidence  
24 to support a finding that James Lutz himself knowingly filed false tax returns. Lutz rests this argument on the  
25 assertion that the provisions of the PMPA under which Chevron seeks termination require intent on the  
26 franchisee alone and do not contemplate vicarious intent. Chevron does not dispute that the text of both the  
27 lease and the PMPA call for termination only upon knowing misconduct by the dealer.<sup>3</sup> Rather, they argue  
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1 that the intent may be imputed under agency law because James Lutz's sons are his agents with respect to  
2 the financial management of the service station.

3 Agency law provides that a principal may be held civilly liable under tort law or other civil causes of  
4 action for the fraud of an agent acting with apparent authority. American Soc. of Mech. Eng'rs, Inc. v.  
5 Hydrolevel Corp., 456 U.S. 556, 565 (1982). Where civil liability requires fraudulent intent, the fraudulent  
6 intent of the agent will suffice. United States ex rel. Rosales v. San Francisco Housing Authority, 173 F.  
7 Supp. 2d 987, 1003 (N.D. Cal. 2001) (Legge, J.). The present action, however, does not concern a  
8 tortious act or other form of civil liability, such as breach of contract. Chevron does not point to any cases  
9 in which a court has found a breach of contract rested solely on the agency relationship between one of the  
10 signatories and a third party.<sup>4</sup>

11 California law provides that "a principal is responsible to third persons . . . for [his agent's] willful  
12 omission to fulfill the obligations of his principal." Cal. Civ. Code § 2338. Whether a particular obligation  
13 set forth in a contract may be breached by an agent of one of the signatories depends on the nature of  
14 contractual provision at issue. Accordingly, an examination of whether Lutz's sons can breach the relevant  
15 duties imposed under the contract must begin with the contract itself.

16 The provisions of both the lease agreement and the PMPA can be distinguished into two types:  
17 those that place requirements on the operation of the franchise and those that place personal requirements  
18 on the dealer. The former category includes such obligations as requiring the franchisee to pay its monthly  
19 rents, Lease Agreement ¶ 7(b)(3); 15 U.S.C. § 2802(c)(8), and to close the premises for no more than  
20 seven consecutive days, 15 U.S.C. § 2802(c)(9)(A). These terms do not refer to personal obligations of  
21 the dealer, but instead require the dealer to maintain certain standards for the operation of the business,  
22 presumably in order to maintain quality and uniformity. If these standards are not met, the dealer has failed  
23 his obligation under the lease agreement whether the dealer or his employees are directly responsible,  
24 unless the breach was beyond his "reasonable control." 15 U.S.C. § 2801(13)(B); see also O'Shea v.  
25 Amoco Oil Co., CCG Bus. Franchise Guide ¶ 9152 (D.N.J. 1988) (finding service station franchisee  
26 breached provision requiring twenty-four hour operation even if station had closed due to "employee  
27 misconduct").  
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Both the lease agreement and the PMPA, however, also contain requirements which are undoubtedly personal to the franchisee, and which ensure that the dealer remains fit to carry out the franchise relationship. For example, termination is warranted if the dealer dies or becomes physically or mentally unable to provide for the continued operation of the station. Lease Agreement ¶¶ 7(b)(9), 7(b)(12); 15 U.S.C. § 2802(c)(3). Both the PMPA and the lease agreement also impose character requirements on dealers, Toliver Dec. ¶ 13, providing for termination if the dealer commits fraud or is convicted of a felony involving moral turpitude. Lease Agreement ¶¶ 7(b)(8), 7(b)(11); 15 U.S.C. §§ 2802(c)(1), 2802(c)(12). Allowing termination upon fraud or conviction of a felony involving moral turpitude recognizes that a “[g]ood faith belief of the franchisor that the franchisee is untrustworthy or engages in fraudulent practices undermines the entire franchise relationship.” See Humboldt Oil Co. v. Exxon, Co., 695 F.2d 386, 388–89 (9th Cir. 1982).

An agent of the dealer cannot fail to fulfill those obligations which pertain to the dealer personally rather than the operation of the franchise. The independent fraudulent actions of a dealer’s employee do not reflect directly on the dealer’s integrity and trustworthiness, and therefore do not undermine the franchise relationship in the same manner as fraudulent acts by the dealer himself.<sup>5</sup> Employee misconduct about which the employer was unaware can be addressed through means less drastic than terminating the franchise, such as dismissal of the offending employee. Construing the provisions of the PMPA in favor of protecting franchisees from termination, the court finds that neither the contract nor the statute calls for termination simply because a dealer’s employees have engaged in fraud or knowingly violated federal, state or local law. Accordingly, Chevron must show that James Lutz himself intentionally violated federal, state, or local law in order to warrant termination of the franchise.

### III. Evidence of Intent to File Incorrect Tax Returns

The court finally turns to evidence that James Lutz intended to violate federal and state income tax laws. Because direct evidence of fraudulent intent is rarely available, courts have recognized various types of circumstantial evidence which support a finding of intent to violate tax laws. Bradford v. Comm’r of Internal Revenue, 796 F.2d 303, 307 (9th Cir. 1986). These badges of fraud include: (1) understatement of income, (2) inadequate records, (3) failure to file tax returns, (4) implausible or inconsistent explanations

1 of behavior, (5) concealing assets, and (6) failure to cooperate with tax authorities. Id. Chevron argues  
2 that the evidence shows that Lutz understated income by filing the false tax returns and kept insufficient  
3 records for the auditor to determine the service station's gross profit. Chevron also maintains that the  
4 explanations offered by Tim and Dan Lutz that they began calculating the gross sales from the sales tax  
5 because the computer generated figure for total sales was not accurate are implausible.

6 A. Understatement of Income

7 As Chevron correctly states, the consistent and substantial understatement of income can itself  
8 constitute evidence of fraud. Laurins v. Comm'r of Internal Revenue, 889 F.2d 910, 913 (9th Cir. 1989);  
9 Ruark v. Comm'r of Internal Revenue, 449 F.2d 311, 313 (9th Cir. 1971) ("Gross understatement of  
10 income may in itself be a basis for a finding of fraud"). Courts have generally found an understatement of  
11 income to be itself evidence of fraud only where a sustained pattern of understatement exists over several  
12 years. See Lollis v. Comm'r of Internal Revenue, 889 F.2d 910 (9th Cir. 1989) (upholding finding of fraud  
13 based on consistent underreporting of large sums over three years by a former tax litigation attorney);  
14 Ruark (upholding fraud finding where taxpayer had declared approximately 1% of her income over a four  
15 year period); cf. Loftin & Woodard, Inc. v. United States, 577 F.2d 1206 (5th Cir. 1978) (noting that  
16 "two years in succession do not a pattern make. . . . The mere understatement of income, standing alone, is  
17 not enough [to prove fraud].").

18 The calculation technique employed by Tim Lutz caused significant understatement of income on the  
19 income tax returns for James Lutz and the Lutz partnership. On the returns for the partnership, Lutz initially  
20 understated the total sales and gross profit of the service station by more than \$200,000. 1999 Partnership  
21 Return & 1999 Amended Partnership Return, Snyder Dec., Exh. I & J. This constituted an  
22 understatement of total sales by approximately 2-3%, but an understatement of gross profit by 23%. The  
23 calculation resulted in Lutz reporting only 54% of his actual taxable personal income—\$142,495 rather  
24 than \$262,713. 1999 Amended Personal Return, Snyder Dec., Exh. J. Although significant in its amount,  
25 this understatement of income occurred in a single year only. The following year, after the Chevron audit,  
26 Tim Lutz filed income tax returns that are not alleged to be inaccurate and also filed amended returns for the  
27 1999 year. While the understatement of income might provide evidence of fraud when offered with other  
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1 facts, it does not rise to the level of gross or sustained understatement which alone would support a finding  
2 of fraud.

3 Chevron also asserts that Lutz underpaid his state sales taxes. Lutz maintains that errors in  
4 calculating nontaxable sales resulted in him overpaying sales through the first quarter of 1999, and  
5 afterwards in him underpaying income tax while paying correct sales taxes. Lutz provides no evidence of  
6 this other than Tim Lutz's assertion that this occurred. Tim Lutz Dec. ¶ 7. However, Tim Lutz's assertions  
7 in his declaration as to how he calculated the sales tax payments for the second quarter of 1999 and  
8 afterwards, id. ¶ 10, directly contradict his own detailed deposition testimony as to how he performed the  
9 same calculation. Tim Lutz Dep. at 65:14–67:19. Tim Lutz's deposition testimony, supported by the  
10 monthly sales reports and tax worksheets, indicates that by subtracting nontaxable sales from an incorrect  
11 "gross sales" figure that actually included only taxable sales, Tim Lutz essentially deducted nontaxable sales  
12 twice. This resulted in him understating taxable sales by about 0.1% and therefore underpaying the state  
13 sales tax by a similar amount, or approximately \$155 per quarter.<sup>6</sup> Id.; Second Quarter 1999 Sales Tax  
14 Return, Snyder Dec., Exh. L. The court does not find this understatement significant enough to constitute  
15 fraud whether considered alone or together with the income tax return errors.

16 B. Inadequate Records

17 Chevron asserts that the Lutzes have failed to keep adequate business records. The outside  
18 auditor, Everett Harry, indicates that at the time he made his report available, the Lutzes had still not  
19 provided business records which adequately explained discrepancies and had not turned over specific  
20 documents, such as annual financial statements. Harry Dec. ¶ 15; Harry Dec., Exh A. Chevron maintains  
21 that the Lutzes' records are inadequate because no business records (as opposed to accountant's  
22 spreadsheets) "explain" discrepancies between Chevron records and the reported income.

23 Chevron's allegations do not go to the adequacy of Lutz's records, but rather to the plausibility of  
24 Lutz's explanation. The Lutzes acknowledge that they miscalculated gross sales for a certain period.  
25 Chevron does not specify what further explanation is required to account for the discrepancies between  
26 figures. Chevron also fails to point to any piece of factual information regarding the finances of the service  
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1 station which cannot be determined from the records presently available. Chevron has therefore failed to  
2 make a showing that service station kept inadequate records.

3 C. Implausible or Inconsistent Explanations of Behavior

4 Chevron relies heavily on the implausibility of the Lutzes explanation for why Lutz understated his  
5 income on the 1999 returns. Chevron first notes the improbability that James Lutz, inexperienced though he may  
6 be in the area of taxes, failed to notice that his personal income tax return listed his income as \$142,495,  
7 only 54% of the correct figure of \$262,713. 1999 Amended Personal Return, Snyder Dec., Exh. J. This  
8 argument simply amounts to a restatement of Chevron's position on the first indicia of fraud, that Lutz's  
9 understatement of income itself is so significant as to constitute evidence of intent to violate tax laws. As  
10 such, it does not gain additional weight by Chevron's reframing it to address a different factor in the test.

11 Chevron also points to several problems in the explanation of how the miscalculations of total sales  
12 could be an innocent mistake on the part of Tim and Dan Lutz, including: (1) Tim Lutz, an experienced  
13 CPA, made basic errors in calculating total sales; (2) the Lutzes asserted the computer was generating  
14 incorrect sales information while using the same system for years; (3) Tim Lutz changed from using  
15 computer generated total sales data to calculating total sales at the same time as the profitability of the  
16 station dropped; and (4) Tim Lutz's assertions that he properly calculated sales taxes beginning with the  
17 second quarter of 1999 is inconsistent with his deposition testimony and the worksheets for the sales tax  
18 calculation which suggest he underpaid the state sales tax.

19 While Lutz takes issue with the inferences drawn from the facts presented by Chevron, he does not  
20 undermine the factual basis for Chevron's argument nor present a persuasive reason why a jury could not  
21 draw the inference that his sons' explanation for the inaccuracies is implausible. The question before the  
22 court, however, is not the intent of Dan or Tim Lutz, but of James Lutz, the sole franchisee. Chevron has  
23 offered no additional evidence suggesting implausibility to James Lutz's explanation that his sons mishandled  
24 the sales figures and that he did not notice the irregularities in the tax returns.

25 D. Other Badges of Fraud

26 None of the other badges of fraud are present in this action. Far from failing to cooperate with the  
27 tax authorities, it is uncontested that Tim Lutz filed amended 1999 returns as soon as the error was  
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1 discovered through the Chevron audit and corrected the 2000 returns before they were filed. Tim Lutz  
2 Dec. ¶ 17. Nor are there any allegations that James Lutz has ever failed to file tax returns or concealed  
3 assets, or that any other financial irregularities or allegations of wrongdoing arose during the thirty-four  
4 years he has maintained the dealership.

5 E. Conclusion on Fraudulent Intent

6 The only evidence Chevron offers on fraudulent intent on the part of James Lutz is a single occasion  
7 in his thirty-four years of operating the service station on which he filed tax returns listing only about half of  
8 his actual personal income. Such an isolated understatement of income alone is insufficient to support a  
9 finding of fraudulent intent. Loftin & Woodard, 577 F.2d at 1239. From the facts before the court, no  
10 reasonable jury could infer that James Lutz intended to violate federal and state law by under-reporting  
11 income on his 1999 tax returns.

12  
13 CONCLUSION

14 For the foregoing reasons, the court GRANTS defendant's motion for partial summary judgment  
15 on the issue of intent.

16  
17 IT IS SO ORDERED.

18 Dated: July 10, 2003

19 /s/  
MARILYN HALL PATEL  
Chief Judge  
United States District Court  
Northern District of California

ENDNOTES

1. Chevron's records indicate that the Service Station gross sales totaled \$8,335,204, in 1999 and \$10,029,108 in 2000. Harry Report to Chevron Manager T.S. Toliver, Harry Dec., Exh A at 11. The discrepancies discovered by Harry fall short of Chevron's data by 2.4% in 1999 and by 3.2% in 2000.
2. Chevron also claims that by failing to maintain records required by the Dealer Agreements, Lutz has failed to comply with provisions of the franchise agreement which are "both reasonable and of material significance to the franchise relationship," 15 U.S.C. § 2802(b)(2)(A). Compl. ¶¶ 17, 18, 27(a). Because the issue of intent on which Lutz seeks summary judgment does not arise in the allegation of insufficient record-keeping, the court does not address this statutory ground for termination in this order.
3. As discussed ante, both the Dealer Lease and the PMPA allows termination when the dealer, or franchisee, engages in fraud or knowingly fails to comply with federal, state or local law. Lease Agreement, Snyder Dec., Exh A ¶¶ 7(b)(4), 7(b)(8). The Dealer Lease designates the Dealer as James Lutz. *Id.* ¶ 1. In other provisions for termination in the Dealer Lease, the term "Dealer" is used to mean the individual signatory to the contract. For example, termination is warranted upon prolonged physical or mental disability of Dealer which prevents Dealer from providing for proper operation of the premises, *id.* ¶ (7)(b)(9); upon Dealer's conviction for a felony involving moral turpitude, *id.* ¶ (7)(b)(11); or in the event of Dealer's death, *id.* ¶ (7)(b)(12). The termination provisions of the PMPA employ the term franchisee, which is defined as a retailer or distributor. 15 U.S.C. § 2801(4). A retailer is in turn described as "any person" who purchases motor fuel for sale to the general public. 15 U.S.C. § 2801(7). The PMPA contains provisions similar to those in the lease for termination upon prolonged disability of the franchisee and conviction of the franchisee of a felony involving moral turpitude. 15 U.S.C. §§ 2802(c)(3), 2802(c)(12).
4. Chevron does cite O'Shea v. Amoco Oil Co., CCG Bus. Franchise Guide ¶ 9152 (D.N.J. 1988), in which the court made reference to the agency relationship in finding that a dealer breached a provision of his lease agreement requiring twenty-four hour operation, even if the station had closed due to "employee misconduct." The provision at issue in O'Shea did not govern only the actions of the dealer himself, but required simply that the station operate twenty-four hours per day. Even without invoking agency law, O'Shea was in breach of this provision when the station closed regardless of who was responsible for the closure, unless the failure to abide by terms of the provision was "beyond the reasonable control of the franchisee." 15 U.S.C. § 2801(13)(B).
5. When a dealer supervises operation of the franchise so loosely as to allow employees to conduct business fraudulently without his knowledge, a franchisor may have grounds for termination on other grounds. Chevron has not presented this argument here, however, but has advanced its claim for termination based only on the argument that any fraudulent intent on the part of Lutz's sons may be imputed to him.

1 6. According to Chevron, Tim Lutz improperly deducted \$2587 in nontaxable sales from the “total sales”  
2 figure of \$2,300,333, even though the “total sales” figure actually constituted only taxable sales. Taxed at  
3 the prevailing rate of 6%, the tax on this amount is \$155, or about 0.1% of the \$137,779 that Lutz should  
4 have paid for the quarter. See Second Quarter 1999 Sales Tax Return, Snyder Dec., Exh. L.  
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